Report of Independent Auditors

SELECTIVE SERVICE SYSTEM

Financial Statements

As of and for the Years Ended
September 30, 2006 and 2005

Submitted By

Leon Snead & Company, P.C.
Certified Public Accountants & Management Consultants

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Director, Selective Service System

Independent Auditor's Report

We have audited the balance sheet of the Selective Service System (SSS), as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, and financing (the financial statements) for the years then ended. The objective of our audits was to express an opinion on the fair presentation of those financial statements. In connection with our audit, we also considered the agency's internal control over financial reporting, and tested the agency's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, except for unsupported adjustments amounting to approximately $524,000, in total, on the 2006 financial statements relating to, (i)"Gross Outlays", "Unpaid Obligations", "Total Unpaid Obligated Balance, Net, end of period", and "Net Outlays" in the Statement of Budgetary Resources; (ii) Footnote 2, Fund Balance with Treasury, and (iii) "Other" adjustments in the Statement of Financing; we concluded that SSS's financial statements, as of and for the years ended September 30, 2006 and 2005, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. However, we noted one material weakness involving the internal control over financial reporting, and two reportable conditions relating to IT security and accounting system issues.

The results of our tests of compliance with certain provisions of laws and regulations disclosed no instance of noncompliance that is required to be reported under *Government Auditing Standards,* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements.*

The following sections discuss our opinion on the SSS's financial statements, our consideration of the SSS's internal control over financial reporting, our tests of the SSS's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

Opinion on the Financial Statements

Except as discussed in the following paragraph, we have audited the accompanying balance sheet of the SSS, as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended.

We were unable to obtain sufficient, competent evidence to support adjustments, amounting to approximately $524,000, in total, made to: (i) "Gross Outlays", "Unpaid Obligations", "Total Unpaid Obligated Balance, Net, end of period", and "Net Outlays" in the Statement of Budgetary Resources; (ii) Footnote 2, Fund Balance with Treasury; and (iii) "Other" adjustments" in the Statement of Financing. These adjustments were made by SSS personnel in order to reconcile the cited financial statements, Footnote 2, or to agree with the transmission of budgetary information to Treasury. We could not determine the specific cause for these conditions, but accounting system problems, and errors made by agency personnel in recording journal vouchers were contributing factors.

In our opinion, except for the effects on the 2006 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding adjustments made to "Gross Outlays", " Unpaid Obligations", "Total Unpaid Obligated Balance, Net, end of period", and "Net Outlays" in the Statement of Budgetary Resources; Footnote 2, Fund Balance with Treasury; and "Other" adjustments" in the Statement of Financing, as described above, the financial statements referred to above, present fairly, in all material respects, the financial position of SSS, as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, and financing and for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis section of the agency's Performance and Accountability Report is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America, or OMB Circular A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information, and analysis of the information for consistency with financial statements. However, we did not audit the information and, accordingly, we express no opinion on it.

Internal Control Over Financial Reporting

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered material weaknesses. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control, that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected.

We noted certain matters, discussed in the following paragraphs, involving internal control and its operation that we consider to be reportable conditions. We consider issue number one to be a material weakness.

FINDINGS AND RECOMMENDATIONS

Accounting Operations Need Strengthening

1. SSS needs to strengthen its internal controls over financial reporting, and document the control procedures and related financial management operational processes in the agency's accounting policy manual. With the implementation of new financial and property management systems, and changed financial management processes within the agency, SSS accounting guidance should be updated to contain sufficient information on internal controls over financial reporting. We found problems with accounting operations in several key areas, and financial statements and related footnotes contained unsupported reconciling items, or were not correctly prepared. In addition, the general ledger and property systems, did not function in accordance with Federal accounting requirements which contributed to the extensive efforts needed to prepare the 2006 financial statements and footnotes for SSS.

The Office of Management and Budget (OMB), Circular A-123, *Management's Responsibility for Internal Control*, requires agencies to document internal control activities through the issuance of policies and procedures to help ensure that agency control objectives are met. In addition, the General Accountability Office (GAO), *Internal Control Standards*, requires that internal controls and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. In addition, OMB Circular A-127, *Financial Management Systems*, provides guidance and requirements for agency accounting systems.

Details of the problems identified during our audit follows:

a. **Improvements Needed in Reconciling Fund Balance with Treasury (FBWT)**

SSS was not following regulations issued by the Treasury's Financial Management Service (FMS) that require agencies to prepare their SF 224, Statement of Transactions, (deposits and collections of SSS) from information maintained by the agency's accounting system. Agency personnel were making adjustments to the SF 224 generated by the agency's accounting system prior to submission of the SF 224 to FMS. Some of the adjustments did not have sufficient documentation supporting why the adjustments were necessary. As a result, large differences existed between FMS and SSS deposit and

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disbursement records, which remained uncorrected for extended periods. In addition, a key government-wide control process was over-ridden when the FMS guidance was not followed.

We discussed this problem with Office of the Chief Financial Officer (OCFO) personnel to determine why the general ledger accounts for FBWT did not agree with amounts reported to FMS, and why the differences identified by FMS had not been reconciled and corrected in a timely manner. We were advised that, while documentation was not maintained, the accountant believed that the new accounting system was not correctly reporting the agency's FBWT. Therefore, the accountant attempted to determine what should be reported and revised the SF 224. No documentation was maintained by SSS to support the need for the adjustments.

We reported this internal control weakness to the CFO who advised us that action was taken to correct the process for submission of the SF 224 to FMS, and to reconcile the differences in the reports.

b. Documentation and Approval of Agency Journal Vouchers

Controls over journal voucher (JV) postings need to be improved. We selected five of the 27 JVs processed through June 30, 2006, to determine if they were properly supported, the accounts and amounts posted to the general ledger were correct, and if they were reviewed and approved by a supervisor prior to processing the entries to the general ledger.

Our test identified problems with all five JVs reviewed. For three of the JVs, there was no documentation to support amounts or accounts posted. The remaining two JVs were prepared in error. We expanded our audit tests over JV processing to the fourth quarter of the fiscal year and found some improvement with the documentation for JVs. However, we continued to find JVs with insufficient documentation, incorrect amounts or posted to the wrong account. Also, the JVs were processed without supervisory review and approval.

JVs are prepared to process manual entries to the general ledger. The documents are processed without the full benefit of internal control processes incorporated into an automated accounting system. Therefore, if not properly controlled and documented, JV processing can result in incorrect general ledger entries, and in incorrect financial reporting. Controls over these transactions are critical since the JVs bypass accounting system controls and established SGL posting models. GAO Internal Control Standards provide key duties and responsibilities that need to be divided or segregated among different people to reduce the risk of error or fraud. This would include separating the responsibilities for authorizing transactions, processing and recording them, and reviewing the transactions. The Standards also indicate that internal control procedures and other significant events need to be clearly documented.

c. **Preparation of Interim and Final Financial Statements**

SSS's interim and final financial statements were not prepared in accordance with OMB Circular A-136 and Federal Accounting Standards Advisory Board (FASAB) Standards. We attributed this problem to the turnover of key staff members within the OCFO. As a result, SSS interim financial statements did not represent the full cost of operations of the agency, and the year-end financial statements contained errors.

Our audit found that some expenses were not included in the interim statements, including FECA liability and actuarial liability, accrual of payroll and benefits costs, imputed costs, and depreciation. The statements also contained unsupported reconciling items used to balance several line items. While some of these problems were corrected for the year-end statements, other problems remained. For example, during our review of the financial statements, as of September 30, 2006, we found unsupported adjustments to line items on the Statements of Budgetary Resources and Financing in order to make the statements agree with other required financial statements, or the agency's SF 133, Report on Budget Execution and Budgetary Resources. In addition, information provided in Footnote 2 to the statements did not accurately report certain line items on the financial statements. These problems required OCFO personnel to take extraordinary actions in order to compile the statements, address problems detected by the audit, and correct identified posting and other accounting system weaknesses.

OMB Circular A-136 provides that agencies must prepare quarterly interim financial statements, and year-end financial statements and footnotes. The Circular also provides the presentation requirements for the statements and footnotes. In addition, the FASAB has issued *Statements of Federal Financial Accounting Concepts and Standards* that provide generally accepted accounting standards for the Federal government.

d. **Budget Controls**

During our audit tests of budget controls, we found that SSS allocates funding based upon its full year apportionment, without regard to the quarterly apportionments approved by the OMB. Funds are allotted to each of the SSS eight cost centers, and the cost center director is responsible for seeing that the individual allotment amounts are not exceeded. In addition, SSS does not obtain from its accounting system sufficient Status of Funds reports which could be used to control funding. We did not identify, for the years of our financial statement audits, that SSS had exceeded any of its quarterly apportionments.

OMB Circular A-11, Preparation, Submission, and Execution of the Budget, provides that "The Antideficiency Act requires OMB to apportion the accounts and to monitor spending; prohibits agencies from spending more than the amounts appropriated or apportioned, whichever is lower; requires that agencies control their spending; and provides penalties for overspending." This section further provides that "The head of

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each agency is required to establish, by regulation, a system of administrative control of funds that: Restricts obligation and expenditure (outlays or disbursements) from each account to the lower of the amount apportioned by OMB or the amount available for obligation and/or expenditure."

Recommendations

1. SSS needs to document its internal control processes over financial reporting, and develop operating policies to provide guidance to agency personnel on the preparation of the SF 224, and the handling of the FBWT reconciliation process.

   Agency Response
   The Agency indicated that it concurred with the findings and recommendations and the recommendation has been adopted and will be incorporated into the Fiscal Manual.

   Auditor Comments
   These actions address the recommendations.

2. SSS should ensure that its SF 224 is prepared from information contained in its general ledger, and establish a requirement that the differences reported on the Statement of Differences are resolved in accordance with FMS regulations.

   Agency Response
   The Agency indicated that it concurred with the findings and recommendations and the recommendation has been adopted and will be incorporated into the Fiscal Manual.

   Auditor Comments
   These actions address the recommendations.

3. Ensure that JVs are prepared with appropriate supporting documentation, and reviewed and approved by a supervisor prior to processing to the accounting system.

   Agency Response
   The Agency indicated that it concurred with the findings and recommendations and the recommendation has been adopted and will be incorporated into the Fiscal Manual.

   Auditor Comments
   These actions address the recommendations.

4. Review JVs processed in fiscal year 2006 to ensure the documents were processed correctly.

Agency Response
The Agency indicated that it concurred with the findings and recommendations and the review will be completed by the end of the second quarter of fiscal year 2007.

Auditor Comments
These actions address the recommendations.

5. Perform a comprehensive analysis to identify the reasons unsupported adjustments are needed to reconcile SSS's year-end financial statements. Develop a time-phased corrective action plan to ensure issues identified are resolved in a timely manner.

Agency Response
The Agency indicated that it concurred with the findings and recommendations and will be completed by the Financial Management Directorate and coordinated for my approval by the end of the first quarter of FY 2007

Auditor Comments
These actions address the recommendations.

6. Implement procedures to control funding, on a quarterly basis, as required by OMB.

Agency Response
The Agency indicated that it did not concur with the finding since funds are allocated incrementally during the course of the year. However, to ensure compliance with OMB directives the new fiscal manual will include a chapter on obligation and expenditure controls and ensure that the cost centers can not exceed apportionments or allotments whichever is smaller.

Auditor Comments
These actions address the recommendations.

7. Require cost center directors to provide the CFO with assurances on the Status of Funding on a periodic basis.

Agency Response
The Agency indicated that it concurred with the findings and recommendations and the recommendation has been adopted and will be incorporated into the Fiscal Manual.

Auditor Comments
These actions address the recommendations.

Accounting and Property System Issues

Our audit disclosed several issues with the new accounting and property systems that had a direct impact on the overall financial management operations of SSS.

- The general ledger system contained posting models that were not in compliance with the SGL. For example, we found posting model errors that impacted the Statement of Budgetary Resources in material amounts, and a posting model error dealing with the posting of property. In addition, our audit identified problems with certain account relationships that indicate the potential for additional posting model errors within the accounting system.

- The accounting system's controls were not sufficient to prevent an out-of-balance condition between control accounts and supporting subsidiary records. SSS provided us with various general ledger reports from its accounting system in an attempt to support its accounts payable balances. For our test period, none of the reports supported the information in the general ledger. In addition, our August 2006 analysis showed that the general ledger accounts payable balance could not be supported by source records maintained by SSS.

  There was a breakdown in internal controls within the accounting system that allowed vendors to be paid without an account payable established in the general ledger. This problem continued through out most of the fiscal year, and had a substantial impact on the preparation of the financial statements.

  The Office of Federal Financial Management, *Core Financial System Requirements*, dated January 2006, provide that a system must: (1) update general ledger control accounts consistent with postings made to subsidiary ledgers, and prevent transactions from posting that would cause the general ledger control accounts to be out-of-balance with the subsidiary ledgers; (2) provide information to use in analyzing account balances and in reconciling account balances to information contained in reports and in subsidiary ledgers; and (3) generate a daily *General Ledger and Subsidiary Ledger Exception Report* that provides a list of general ledger control accounts by fund code whose balances differ from the subsidiary ledgers.

- SSS has been unable to use its new property system to control its property inventory, capital assets, or calculate depreciation on capital assets. As a result of these problems, SSS delayed completion of required physical inventories, delayed the completion of the financial statements and footnotes related to property, and the amount of capital assets and related depreciation had to be manually determined.

Recommendations

1. Work with the accounting service provider to correct any posting models that are not in compliance with the SGL. Ensure emphasis is placed on those posting models that could impact the financial statement line items containing unsupported adjustments, and those that impact general ledger accounts that no longer maintain established account relationships.

2. Ensure actions are taken to address the conditions cited above. Strengthen internal control processes to ensure the accounting system complies with CORE accounting requirements discussed above.

   Agency Response
   The agency concurs with the findings and recommendations and has contacted its service provider and task teams are being established to organize to address the issues and develop solutions.

   Auditor Comments
   These actions address the recommendations.

IT Controls In Place but Need Strengthening

3. In an evaluation report, dated September 27, 2006, we reported on SSS's compliance with the Federal Information Security Management Act of 2002. In the evaluation report, we found that improvements were needed in IT security in the following areas: (1) IT security policies and procedures needed to be updated to bring them into compliance with recently released NIST guidance; (2) access controls needed strengthening; (3) security and other specialized training was not provided to SSS personnel located at its Data Management Center (DMC); (4) contingency planning did not address all NIST guidance; (5) more frequent security scans of the SSS network was needed; (6) security documentation for the Registration system did not meet NIST requirements; (7) capital planning for IT systems did not meet OMB requirements; and (8) the agency's security controls over sensitive personally identifiable information needed strengthening.

Since these issues have been previously reported to SSS, and SSS has taken actions to address these areas, we are making no recommendations in this report.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards*, and OMB Bulletin No. 06-03.

Responsibilities

Management Responsibilities

Management of the SSS is responsible for: (1) preparing the financial statements in conformity with generally accepted accounting principles; (2) establishing, maintaining and assessing internal control to provide reasonable assurance that the broad objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and (3) complying with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

Auditor Responsibilities

Our responsibility is to express an opinion on the fiscal year 2006 and 2005 financial statements of SSS based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 06-03. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes: (1) examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessing the accounting principles used and significant estimates made by management; and (3) evaluating that our audits provide a reasonable basis for our opinion. We believe our audits provide a reasonable basis for our opinion.

In planning and performing our audit, we considered SSS internal control over financial reporting by obtaining an understanding of the agency's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03, and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by FMFIA. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not express an opinion, thereon.

As required by OMB Bulletin No. 06-03, with respect to internal control related to performance measures determined by management to be key and reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether SSS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and significant provisions of contracts, which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the SSS. Providing an opinion on compliance with certain provisions of laws, regulations, and significant contract provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

laws, regulations, and significant contract provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03, auditors are generally required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level specified in the *Federal Financial Management Improvement Act* (FFMIA). However, the Accountability of Tax Dollars Act, which requires SSS to prepare and submit, audited financial statements to Congress, and the Director of OMB, did not extend to SSS the requirement to comply with FFMIA. Consequently, we did not test, nor are we reporting on, the agency's compliance with FFMIA.

Agency Response and Auditor Comments

The agency provided a written comment to the draft report. The agency concurred with the findings and recommendations and adopted the actions contained in the recommendations, or provided acceptable alternatives. We considered the response sufficient to address all recommendations. We have provided a copy of the response, in its entirety, as an attachment to this report.

Distribution

This report is intended solely for the information and use of the management of SSS, the OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Leon Snead & COMPANY, PC
Leon Snead & Company, P.C.
November 7, 2006

THE DIRECTOR OF SELECTIVE SERVICE
Arlington, Virginia 22209-2425

November 9, 2006

Mr. Leon Snead
Leon Snead & Company
41 Hungerford Drive, Suite #400
Rockville, Maryland 20850

Dear Mr. Snead:

In response to your letter dated November 8, 2006, I am transmitting herewith the Selective Service System's responses to the Draft Audit Report.

If you have any questions, please call Mr. William Reese at (703) 605-4028 or me at (703) 605-4010.

Sincerely,

William A. Chatfield

William A. Chatfield

Enclosure

RESPONSES TO DRAFT AUDIT REPORT

- **Improvements Needed in Reconciling Fund Balance with Treasury (FBWT)**

  SSS was not following regulations issued by the Treasury's Financial Management Service (FMS) that require agencies to prepare their SF 224, Statement of Transactions, (deposits and collections of SSS) from information maintained by the Agency's accounting system. Agency personnel were making adjustments to the SF 224 generated by the Agency's accounting system prior to submission of the SF 224 to FMS. Some of the adjustments did not have sufficient documentation supporting why the adjustments were necessary. As a result, large differences existed between FMS and SSS deposit and disbursement records, which remained uncorrected for extended periods. In addition, a key government-wide control process was over-ridden when the FMS guidance was not followed.

  We discussed this problem with Office of the Chief Financial Officer (OCFO) personnel to determine why the general ledger accounts for FBWT did not agree with amounts reported to FMS, and why the differences identified by FMS had not been reconciled and corrected in a timely manner. We were advised that, while documentation was not maintained, the accountant believed that the new accounting system was not correctly reporting the agency's FBWT. Therefore, the accountant attempted to determine what should be reported and revised the SF 224. No documentation was maintained by SSS to support the need for the adjustments.

Recommendation 1: - SSS needs to document its internal control processes over financial reporting, and develop operating policies to provide guidance to agency personnel on the preparation of the SF 224, the handling of the FBWT reconciliation process.

SSS Response - Concur with findings and recommendations; the stated recommendation has been adopted and will be incorporated and reflected as part of the revision of the Agency's Fiscal Manual.

Recommendation 2: - SSS should ensure that its SF 224 is prepared from information contained in its general ledger, and establish a requirement that the Statement of Differences is resolved in accordance with FMS regulations.

SSS Response – Concur with findings and recommendations; the stated recommendations have been adopted and will be incorporated and reflected as part of the revision of the Agency's Fiscal Manual.

- **<u>Documentation and Approval of Agency Journal Vouchers</u>**

  Controls over Journal Voucher (JV) postings need to be improved. We selected 5 of the 27 JVs processed through June 30, 2006, to determine if they were properly supported, the accounts and amounts posted to the general ledger were correct, and if they were reviewed and approved by a supervisor prior to processing the entries to the general ledger.

  Our test identified problems with all five JVs reviewed. For three of the JVs, there was no documentation to support amounts or accounts posted. The remaining two JVs were prepared in error. We expanded our audit tests over JV processing to the fourth quarter of the fiscal year and found some improvement with the documentation for JVs. However, we continued to find JVs with insufficient documentation, incorrect amounts or posted to the wrong account. Also, the JVs were processed without supervisory review and approval.

  Journal Vouchers are prepared to process manual entries to the general ledger. The documents are processed without the benefit of internal control processes inherently incorporated into an automated accounting system. Therefore, if not properly controlled and documented, JV processing can result in incorrect general ledger entries, and in incorrect financial reporting. Controls over these transactions are critical since the JVs bypass accounting system controls and established SGL posting models. GAO Internal Control Standards provide key duties and responsibilities that need to be divided or segregated among different people to reduce the risk of error or fraud. This would include separating the responsibilities for authorizing transactions, processing and recording them, and reviewing the transactions. The Standards also indicate that internal control procedures and other significant events need to be clearly documented.

<u>Recommendation 3</u>: Ensure that Journal Vouchers are prepared with appropriate supporting documentation, and reviewed and approved by a supervisor prior to processing to the Accounting system.

<u>SSS Response</u> – Concur with findings and recommendation, the stated recommendation has been adopted and will be reflected as part of the revision of the Agency's Fiscal Manual.

<u>Recommendation 4</u>: Review Journal Vouchers processed in fiscal year 2006 to ensure they were processed correctly.

<u>SSS Response</u> – Concur with findings and recommendation, the stated recommendation will be conducted as a special assignment tasking to be completed by the 2nd quarter of FY 2007.

- **<u>Preparation of Interim and Final Financial Statements</u>**

SSS' interim and final financial statements were not prepared in accordance with OMB Circular A-136 and Federal Accounting Standards Advisory Board (FASAB) Standards. We attributed this problem to the turnover of key staff members within the OCFO. As a result, SSS interim financial statements did not represent the full cost of operations of the Agency, and the financial statements contained errors. Several expenses were not included in the interim statements, including FECA liability and actuarial liability, accrual of payroll and benefits costs, imputed costs, property and depreciation. The statements also contained unsupported reconciling items used to balance several line items.

While some of these problems were corrected for the year-end statements, other problems remained. For example, during our review of the financial statements, as of September 30, 2006, we found unsupported adjustments to line items on the Statements of Budgetary Resources and Financing to make the statements agree with other required financial statements, or the Agency's SF 133, Report on Budget Execution and Budgetary Resources. In addition, information provided in Footnote 2 did not accurately report certain line items on the financial statements. These problems required OCFO personnel to take extraordinary actions in order to compile the statements, address problems detected by the audit, and correct identified posting and other accounting system weaknesses.

OMB Circular A-136, Financial Statement Reporting, provides that agencies must prepare quarterly interim financial statements, and year-end financial statements and footnotes. The circular also provides the presentation requirements for the statements and footnotes. In addition, the Federal Accounting Standards Advisory Board (FASAB) has issued Statements of Federal Financial Accounting Concepts and Standards that provide the generally accepted accounting standards for the Federal government. Federal agencies are required to follow the FASAB standards and presentation requirements in OMB Circular A-136.

<u>Recommendation 5</u>: - Perform a comprehensive analysis to identify the reasons unsupported adjustments are needed to reconcile financial statement line items. Develop a detailed time-planned corrective action plan to ensure issues identified are reviewed in a timely manner.

<u>SSS Response</u> – Concur with findings and recommendation, the stated recommendation will be incorporated as an independent action to be completed by the Financial Management Directorate and coordinated for my approval by the end of the first quarter of FY 2007.

- **Budget Controls**

  During our audit tests of budget controls, we found that SSS allocates funding based on its full year apportionment, without regard to the quarterly apportionments approved by the OMB. Funds are allotted to each of the SSS eight cost centers, and the cost center director is responsible for seeing that the individual allotment amounts are not exceeded. In addition, SSS does not obtain from its accounting system sufficient Status of Funds reports which could be used to control funding. We did not identify, for the years of our financial statement audits, that SSS had exceeded any of its quarterly apportionments.

  OMB Circular A-11, Preparation, Submission, and Execution of the Budget, provides that "The Antideficiency Act requires OMB to apportion the accounts and to monitor spending; prohibits agencies from spending more than the amounts appropriated or apportioned, whichever is lower; requires that agencies control their spending; and provides penalties for overspending." This section further provides that "The head of each agency is required to establish, by regulation, a system of administrative control of funds that: Restricts obligation and expenditure (outlays or disbursements) from each account to the lower of the amount apportioned by OMB or the amount available for obligation and/or expenditure." Section 121.11 provides that, "The agency system of administrative control of funds should be designed to keep obligations and expenditures from exceeding apportionments and allotments or from exceeding budgetary resources available for obligation, whichever is smaller."

Recommendation 6: - Implement procedures to control funding, on a timely basis, as required by the Office of Management and Budget.

SSS Response – Non-concur with finding since funds are allocated "incrementally" during the course of the fiscal year. Though funds are not allocated to align with OMB quarterly apportionments, they are allotted to each of the eight SSS Cost Centers in accordance with estimated funding requirements for the period stated (all requirements total an amount less than the OMB quarterly apportionment). Contrary to the stated finding, the "Head" of each Cost Center has the capability to obtain and review the "Status of Funds" Report for his/her Cost Center at anytime to make the appropriate management decision(s).

However, to ensure compliance with the stated OMB directives and guidance, the next revision of the Agency's Fiscal Manual will include a new chapter to establish obligations and expenditure controls monitored by the FM Directorate (Budget Division) as well as each Cost Center to ensure that they do not exceed

Apportionments and Allotments or budgetary resources available for obligation, Recommendation 7: - Require Cost Center Directors to provide the CFO assurances of the Status of Funding on a periodic basis.

SSS Response – Concur with recommendation, the stated recommendation will be adopted effective immediately and the requirement will be incorporated, documented, and reflected as part of the revision of the Agency's Fiscal Manual.

- **Accounting and Property System Issues**

  Our audit disclosed several issues with the new accounting and property systems that had an adverse impact on the overall financial management operations of SSS.

  The general ledger system contained posting models that were not in compliance with U.S. Standard General Ledger (SGL). For example, we found posting model errors that impacted the Statement of Budgetary Resources in material amounts, and a posting model error dealing with the posting of property. In addition, our audit identified problems with certain account relationships that indicate the potential for additional posting model errors within the accounting system.

  The accounting system's controls were not sufficient to prevent an out-of-balance condition between control accounts and supporting subsidiary records. SSS provided us with various general ledger reports from its accounting system in an attempt to support its accounts payable balances. For our test period, none of the reports supported the information in the general ledger. In addition, source records maintained by the SSS did not agree with the general ledger or the subsidiary ledger. Our August 2006 analysis showed that the general ledger accounts payable balance could not be supported by source records maintained by SSS.

  There was a breakdown in internal controls within the accounting system that allowed vendors to be paid without an accounts payable established in the general ledger. This problem continued throughout most of the fiscal year, and had a substantial impact on preparation of the financial statements.

  The Office of Federal Financial Management, Core Financial System Requirements, dated January 2006, provide that a system must: (1) update general ledger control accounts consistent with postings made to subsidiary ledgers, and prevent transactions from posting that would cause the general ledger control accounts to be out-of-balance with the subsidiary ledgers; (2) provide information to use in analyzing account balances and in reconciling account balances to information contained in reports and in subsidiary ledgers; (3) generate a daily *General Ledger and Subsidiary Ledger Exception Report* that provides a list of general ledger control accounts by fund code whose balances differ from the subsidiary ledgers.

SSS has been unable to use the new property system to control its property inventory, capital assets, or calculate depreciation on capital assets. As a result of these problems, SSS delayed completion of required physical inventories, delayed the completion of the financial statements and footnotes related to property, and the amount of capital assets and related depreciation had to be manually determined.

Recommendations:

1. SSS should work with its service provider to correct any posting models that are not in compliance with the SGL. Emphasis should be placed on those posting models that could impact the financial statement line items containing unknown differences, and those that impact general ledger accounts that no longer maintain established account relationships.

2. SSS needs to work with its accounting services provider to ensure that actions are taken to address the conditions discussed above. Internal control processes need to be strengthened to ensure the accounting system complies with the CORE accounting requirements discussed above.

SSS Response – Concur with findings and both recommendations; the service provider has been "officially" contacted and advised of these findings and recommendations and coordination is being established to organize the appropriate number of task teams to address the issues and present proposed solutions to be implemented to eliminate these errors and problems.

- **IT Controls In Place but Need Strengthening**

SSS Information Technology (IT) controls need to be strengthened to meet IT security requirements. We found problems in the following areas: (1) IT security policies and procedures needed to be updated to bring them into compliance with recently released NIST guidance; (2) access controls needed strengthening; (3) security and other specialized training was not provided to SSS personnel located at its Data Management Center (DMC); (4) contingency planning did not address all NIST guidance; (5) more frequent security scans of the SSS network were needed; (6) required security documentation for the Registration system did not address all NIST requirements; (7) capital planning for IT systems did not meet OMB requirements; and (8) the Agency's security controls over sensitive personally identifiable information needed strengthening.

We have made recommendations to SSS to resolve these problem areas; therefore, we are making no additional recommendations at this time.

SSS Response – A separate response was provided earlier with the "official" FISM Audit Report.